BEFORE
THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Commission's Investigation of the Financial Impact of the Tax Cuts and Jobs Act of 2017 on Regulated Ohio Utility Companies	))))	Case No. 18-47-AU-COI

INITIAL BRIEF OF THE OHIO MANUFACTURERS' ASSOCIATION ENERGY GROUP ON THE JULY 10, 2018 HEARING

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I. INTRODUCTION

The Public Utilities Commission of Ohio (Commission) has been clear that this proceeding does not pose a question of whether regulated public utilities will pass the benefits resulting from the Tax Cuts and Jobs Act of 2017 (TCJA) on to customers, but how and when those benefits will be returned to customers.[1]

More specifically, this docket was opened to "consider the impacts of the Tax Cuts and Jobs Act of 2017 and determine the appropriate course of action to pass benefits resulting from the legislation on to ratepayers."[2] While the Commission considers the broad impact of the law on regulated public utilities, it ordered those utilities to record their tax savings resulting from the TCJA as deferred liabilities on their books, starting on January 1, 2018. Yet, some Ohio electric distribution utilities (EDUs) opposed the Commission's attempts to ensure that customers receive the full benefits of the TCJA. The July 10, 2018 hearing arose after Duke Energy Ohio, Inc. (Duke), The Ohio Power Company (AEP Ohio), The Toledo Edison Company, The Cleveland Electric Illuminating Company, and the Ohio Edison Company (collectively, FirstEnergy), and the Dayton Power and Light Company (DP&L) (collectively, EDUs) filed a joint application for rehearing, challenging, among other things, the Commission's authority to issue the deferral order.[3]

The Ohio Manufacturers' Association Energy Group (OMAEG) represents Ohio manufacturers, who are customers of the Ohio public utilities. OMAEG participated in the July 10, 2018 hearing and now timely submits this post-hearing brief. For the reasons discussed

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1 See Second Entry on Rehearing at ¶ 15 (April 25, 2018) ("However, the Commission intends that all tax impacts resulting from the TCJA will be returned to customers . . .").

2 Entry (January 10, 2018).

3 See Application for Rehearing (February 9, 2018).

above and those articulated herein, the Commission should reject any attempt by the EDUs to unjustly and unreasonably deny Ohio's utility customers the tax relief to which they are entitled under the TCJA. The Commission should reject the Joint Application for Rehearing filed by Ohio's EDUs and uphold its January 10, 2018 order that all regulated public utilities must record their tax savings on their books as deferred liabilities, effective January 1, 2018.

II. PROCEDURAL HISTORY

On February 9, 2018, the EDUs filed a Joint Application for Rehearing that contested the Commission's authority to order the establishment of the deferred liability.[4] In its Second Entry on Rehearing, the Commission affirmed its authority to order the establishment of a deferred liability without prior notice or a hearing as well as the lawfulness of creating a deferred liability that may affect future base rate proceedings. Nonetheless, the Commission granted the Joint Application for Rehearing for the limited purpose of holding a hearing on the narrow question of whether or not public utilities should be required to establish a deferred tax liability, effective January 1, 2018.[5] The Commission rejected all other assignments of error advanced by the EDUs.[6]

On May 24, 2018, the hearing on the limited issue of the establishment of the deferred liability was set for July 10, 2018.[7] Duke and AEP Ohio filed testimony on June 15, 2018, opposing the Commission's ordered deferral,[8] and the Staff of the Commission, the Office of the Ohio Consumers' Counsel (OCC), Industrial Energy Users-Ohio (IEU-Ohio), the Ohio Energy

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[4] Joint Application for Rehearing (February 9, 2018).

[5] Second Entry on Rehearing at ¶¶ 26-31.

[6] Id. at ¶ 34.

[7] Entry at ¶ 9 (May 24, 2018).

[8] See Direct Testimony of William Don Wathen, Jr. (June 15, 2018); Direct Testimony of William A. Allen (June 15, 2018).

Group (OEG), and the Ohio Cable Telecommunications Association (OCTA) filed testimony on June 29, 2018 in support of the deferral order.[9] On July 10, 2018, the Commission took testimony from the parties.[10]

III. DEFERRAL STANDARD

As a general matter, regulated public utilities are directed by the generally accepted accounting principles (GAPP) to recognize and record deferred tax liabilities or assets for the estimated future tax effects attributable to provisional differences based on the law or changes in the law.[11] The Commission has not established standards for reviewing the creation of deferrals associated with regulatory liabilities.[12] But, as Staff Witness Borer notes, there are standards that the Commission has used to evaluate the creation of deferred assets, and these standards can be modified to assist in the consideration of deferred liabilities.[13] Those standards,[14] which have been adjusted to account for the difference between regulatory assets and regulatory liabilities, are instructive:

1. Are the utility's current rates or revenues insufficient to cover the costs associated with the deferral?
2. Are the expense reductions material?
3. Is the reason for the deferral outside of the utility's control?
4. Are the expense reductions atypical and infrequent?

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9 See Testimony of Jonathan J. Borer (June 29, 2018); Direct Testimony of Wm. Ross Willis (June 29, 2018); Direct Testimony of Joseph G. Bowser (June 29, 2018); Direct Testimony of Lane Kollen (June 29, 2018); Direct Testimony of Patricia D. Kravtin (June 29, 2018).

10 See Transcript In the Matter of the Commission's Investigation of the Financial Impact of the Tax Cuts and Jobs Act of 2017 on Regulated Ohio Utility Companies, hearing held on July 10th, 2018 (July 13, 2018).

11 Borer Testimony at 3-4; Bowser Testimony at 5; Kollen Testimony at 3-4.

12 See Borer Testimony at 4.

13 See id. at 4-7.

14 In the context of deferred assets, these standards were relied on by the Commission in *In the Matter of the Application of Duke Energy Ohio, Inc. for Approval to Change Accounting Methods*, Case No. 17-2118-GA-AAM, Finding and Order (April 18, 2018).

5. Will the deferral, if required, significantly affect the financial integrity of the utility?[15]

These factors can be used to assist the Commission in determining whether an order to record a regulatory liability is proper. And, when applied appropriately, the standard supports the proposition that the Commission should uphold the deferral order it issued in this case.

IV. ARGUMENT

A. <u>The Commission's Deferral Order Complies with Ohio Law.</u>

The July 10, 2018 hearing was limited to "the narrow question of whether the utilities should be required to establish a deferred tax liability, effective January 1, 2018."[16] The Commission has already confirmed that R.C. 4905.13 provides the requisite statutory authority to issue the deferral order the EDUs now challenge.[17] Each of the factors the Commission has previously used to evaluate deferrals (discussed above) demonstrate that the Commission's deferral order was not only lawful, but also proper.

First, the rate-regulated utilities have enough revenue to cover the costs of this deferral. All Ohio rate-regulated utilities currently recover an approved revenue requirement from customers that was established based on a 35% federal corporate income tax rate even though the TCJA reduced the federal corporate income tax rate from 35% to 21%.[18] The Commission approved these current rates with the understanding that the utilities would be using the entirety of the funds collected for their federal corporate income tax obligations to pay that tax, and not for any other purpose. Now, under the TCJA, each utility is collecting the same amount from customers, but doing so while paying significantly less to the federal government for income tax

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[15] Borer Testimony at 5-7.

[16] See Entry at ¶ 31 (April 25, 2018).

[17] Id. at ¶ 30.

[18] Borer Testimony at 5.

purposes. The utilities' current rates (and embedded components) were designed to compensate the utilities for the higher tax rate.[19] With the reduction in the federal income tax rate, the utilities have excess revenues collected from customers that are sufficient to cover the deferral associated with the federal income tax rate reduction.[20] Clearly, the rate-regulated utilities can afford to record these savings (which they would not even receive had the TCJA not been enacted) as a deferred liability until the Commission determines the best way to pass tax savings back to customers. Therefore, the first standard is met.

Second, the expense reductions at issue are material. The rate-regulated utilities recover the costs of their federal income tax payments from customers. The tax reduction established by the TCJA affects not only the current income taxes, but also deferred income taxes. The impacts of the TCJA further extend to the Accumulated Deferred Income Taxes (ADIT) levels that are recognized. Given the amount of income that the rate-regulated utilities make, these revenues are certainly substantial, for both the utilities and their customers who provide the tax payments that are no longer necessary under the TCJA. Indeed, all utilities are experiencing a 40% reduction in their federal corporate income tax liability. That figure alone demonstrates that customers would see a material impact from the return of tax savings. The fact that the impact is material is further affirmed by the additional consideration of the excess ADIT balance and the gross revenue conversion factor (GRCF), which are impacted by the reduction in the tax rate.[21] Accordingly, the second criterion is met.

Third, the TCJA is a cause that is indisputably outside of the control of the Commission or any rate-regulated utility. It was proposed, passed, and signed into law at the federal level.

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[19] Id.; Willis Testimony at 5-6.

[20] Id.

[21] Id.; Bowser Testimony at 4; Willis Testimony at 5-6.

Neither the Commission nor any of the utilities it regulates played a significant role in the TCJA's enactment or in determining that the effects of the law would apply to Ohio rate-regulated utilities. As such, the third standard is satisfied for this deferral.

Fourth, the expense reductions at issue in this case are atypical and infrequent. The type of expense reductions caused by the TCJA simply do not arise regularly. Indeed, the corporate income tax law saw a change in this magnitude in 1986,[22] and there are not indications that the law will change substantially in the near future. Ultimately, a 40% reduction in federal corporate income tax liability is an event unlikely to repeat itself in the next several months, years, or even decades. Thus, the fourth criterion is satisfied.

Finally, this deferral will not affect any utility's financial integrity. The Commission ordered all rate-regulated utilities to defer the *savings* they receive under the TCJA, and only those savings. Under the deferral order, no utility is required to record as a deferred liability any revenues that they would not have been paying to the federal government had the TCJA not been enacted. The Commission is attempting to return all *benefits* of the TCJA to customers, no more and no less. Asking utilities to set aside those benefits will not affect their financial integrity. Therefore, no utility will be adversely affected by complying with this deferral order because it coincides with the utilities' own reduction in tax liability under the TCJA. Therefore, the fifth criterion is satisfied for the Commission's deferral order.

[22] Borer Testimony at 6.

B. The EDUs' Arguments Fail to Provide a Justification for the Commission to Reverse its Deferral Order.

Of the EDUs that filed the Joint Application for Rehearing, only Duke and AEP Ohio ultimately filed testimony on this issue and presented witnesses at the July 10, 2018 hearing.[23] This testimony was insufficient to overcome the justifications for the deferral discussed above. Neither Duke Witness William Don Wathen nor AEP Ohio Witness William Allen offer a sufficient justification for the Commission to withdraw or alter its January 10, 2018 deferral order.

Mr. Wathen's testimony purports to use the same five-factor test for deferrals that is discussed above.[24] But his testimony misapplies those factors, which leads to the improper conclusion that the Commission should not have ordered Ohio's rate-regulated utilities to record their tax savings under the TCJA as liabilities on their books. Mr. Wathen begins by arguing that because the Commission has not affirmatively concluded that the utilities' current revenues are sufficient to cover their expenses, the Commission cannot properly assess the first factor of the test.[25] Mr. Allen makes a similar argument, though not in the context of applying the test for deferrals.[26] This argument does not hold water. The Commission directed the utilities to defer only the amount of money that they receive from customers to pay taxes that the utilities are no longer obligated to pay under the TCJA. As discussed above, this accounting order should not affect the utilities' net revenues, because it only concerns funds that were never intended to add to the utilities' net revenue. If there are other factors that Mr. Wathen or the EDUs believe could

[23] See Direct Testimony of William Don Wathen, Jr. (June 15, 2018) (Wathen Testimony); Direct Testimony of William A. Allen (June 15, 2018) (Allen Testimony). DP&L was represented at the July 10, 2018 hearing, but FirstEnergy did not make an appearance.

[24] Wathen Testimony at 8.

[25] Id. at 9-10.

[26] Allen Testimony at 4.

have made a utility's revenues insufficient to cover expenses since it last set its distribution base rates, that utility should file a new rate case. Moreover, the Commission is not required to do a thorough analysis of a utility's entire financial condition before it issues an accounting order related to the limited issue of a reduction in the federal corporate income tax paid by public utilities. Finally, neither Mr. Wathen nor Mr. Allen presents evidence to suggest that the EDUs on behalf of which they offered their testimony are not, in fact, earning a just and reasonable rate of return.

In applying the second factor, Mr. Wathen argues that the Commission must consider the materiality of the deferral in relation to the impact that the deferral will have on a utility's earnings to determine whether a material impact exists.[27] Mr. Wathen notes that Duke has deferred approximately $6 million for its jurisdictional electric distribution business and $4.4 million for its jurisdictional gas business pursuant to the January 10, 2018 deferral order.[28] This amount of money is material to Duke's customers. Perhaps recognizing this, Mr. Wathen cites a prior case for the proposition that any amount "below 1 percent of total operating expenditures" is "presumably immaterial."[29] But this is a misinterpretation of what the Commission actually held. In the case Mr. Wathen refers to, the Commission cited a statement made by *the Staff of the Commission* that the deferral requested by Duke was less than one percent of total operating expenditures as part of a much longer restatements of the arguments made by the parties.[30] Although the Commission ultimately determined that the requested deferral was not material, it did not refer to Staff's 1% argument when it did so and it did not establish a threshold whereby

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27 Wathen Testimony at 10-11.

28 Id. at 7.

29 Id. at 10 (citing *In the Matter of the Application of Duke Energy Ohio, Inc., for Approval to Change Accounting Methods*, Case No. 17-2118-GA-AAM, Finding and Order (April 18, 2018)).

30 Id. at ¶ 18(2).

deferrals of amounts less than 1% of total operating expenditures are presumed to be immaterial.[31]

In any event, Mr. Wathen improperly analogizes the prior deferral request by Duke to the instant case. The previous case concerned Duke's request for a deferred asset, so the Commission considered whether the expense of the deferral would be material to Duke. Here, of course, the Commission is concerned with a deferred liability. Thus, it should consider materiality to customers who, without a deferral, would be left to vastly overcompensate the public utilities for federal income tax expenditures today, without any recourse to recover that overcompensation in the future. Here, the Commission is not faced with the $3 million deferral request in the case Mr. Wathen cited,[32] but rather a deferral that is already over $10 million just for Duke's combined gas and electric operations, and continues to grow. But even if the Commission is inclined to consider the materiality of the deferral to the utilities and not to customers, it should not lose sight of the fact that several utilities, particularly Duke and AEP Ohio, have spent time and resources offering pleadings and testimony contesting the deferral. Certainly, these EDUs would not have gone to such great lengths to avoid deferring their tax savings if they did not believe that they would be materially affected by simply recording the deferral as ordered.

Regarding the third factor, Mr. Wathen concedes that the enactment of the TCJA is beyond the control of the rate-regulated utilities and the Commission, but nonetheless suggests that the third factor may not be met because the Commission has control over the decision to request[33] deferral accounting.[34] By this construction of the third standard, no deferral request (by

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31 Id. at 9.

32 Id. at 3.

33 The Commission did not "request" deferral accounting, it *ordered* the deferral.

a utility or the Commission) could ever satisfy this standard. Any deferral request (of either an asset or a liability) ultimately is requested only when the utility or the Commission decides to request it. According to Mr. Wathen's standard, Duke or any other EDU could not meet this standard when requesting a deferred asset because Duke would have control over whether or not to ask the Commission for the deferral. This result would, of course, be absurd. The Commission should consider whether the entity requesting the deferral has control over the circumstances that led to the request, not whether it had control over the decision to ultimately request the deferral in light of the changed circumstances.

For the fourth factor, Mr. Wathen argues that this change is not atypical or infrequent because the federal corporate income tax could change in the future.[35] Of course, OMAEG acknowledges that Congress always has the power to enact new laws, but the Commission should consider the reality that major changes in this area of the law do not happen regularly—as evidenced by the fact that, as discussed above, the last change in tax law of this magnitude took place over 30 years ago. Mr. Wathen does not offer a concrete basis from which the Commission could infer that another change is coming in the near future. His contention that it is possible for Congress to again change the law does not, alone, mean that this change is typical or frequent, especially given that history shows us that a change of this nature to federal tax law typically does not even occur once per decade.

For the fifth factor, Mr. Wathen again states that the Commission should consider whether existing revenues are just and reasonable.[36] As noted above, the issue of sufficient revenues is appropriately addressed in a rate case. In fact, Duke itself has already addressing this

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[34] Id. at 11.

[35] Id. at 11-12.

[36] Id. at 12.

very issue in its pending distribution rate case.[37] Any other utility could file a similar case should it desire to argue that it is entitled to make a higher rate of return from customers.

Mr. Wathen ends his testimony by saying that the Commission "should apply the existing deferral standard and allow due process to occur."[38] The suggestion that due process is not already occurring is inaccurate. The Commission is already affording all rate-regulated utilities and other stakeholders the opportunity to be heard on this issue before making a decision addressing the impacts of the TCJA—that was the entire point of this proceeding. As discussed herein, the standards for granting a deferral are met in this case. The Commission's ordered deferral does not deny anyone due process. Rather, it ensures that customers will actually receive the TCJA benefits to which they are entitled.

OMAEG would also note that Mr. Allen's testimony about AEP Ohio's separate tax docket is not material to the determination that the Commission is making in this hearing. This hearing was limited to the issue of the deferral order, and the existence of separate, utility-specific proceedings does not affect the Commission's determination as to whether or not the deferral is lawful.

C. <u>The Commission's Order Is Consistent with the Accounting Requirements that the EDUs Already Follow.</u>

As IEU-Ohio Witness Joseph Bowser notes, the EDUs are required to comply with Generally Accepted Accounting Principles (GAAP) and Accounting Standards Codification (ASC) 740.[39] Further, the Federal Energy Regulatory Commission (FERC) requires that the public utilities adjust deferred tax liabilities and assets for changes in tax law or rates in the

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[37] See *In the Matter of the Application of Duke Energy Ohio, Inc. for an Increase in Electric Distribution Rates*, Case Nos. 17-32-EL-AIR, et al.

[38] Wathen Testimony at 14.

[39] Bowser Testimony at 5 (June 29, 2018).

period that the change in enacted.[40] As Mr. Bowser notes, FERC also requires the EDUs to establish a corresponding asset or liability if the actions of a regulator (in this case, the Commission) make it probable that a future increase or decrease in taxes will be paid for by or returned to customers. Given the Commission's stated desire to return tax savings to customers, the public utilities should already be establishing deferred liabilities pursuant to FERC's guidelines, independent of the Commission's directive in this case.

Thus, in addition to it being within the Commission's powers to order the challenged deferral, the deferral is also consistent with GAAP and other accounting principles with which FERC requires public utilities to comply.

[40] Id.

V. CONCLUSION

The Commission's order for rate-regulated Ohio utilities to defer TCJA savings as regulatory liabilities on their books was lawful. The Commission has authority to order deferrals, and doing so in this case was a proper exercise of that authority. As such, the Commission should reject the EDUs' remaining arguments contained in the Joint Application for Rehearing and affirm its January 10, 2018 deferral order.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that a true and accurate copy of the foregoing was served upon all parties of record via electronic mail on August 13, 2018.

/s/ *Brian W. Dressel*
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